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JENNINGS, STROUSS & SALMON, P.L.C.
ATTORNEYS AT LAW
ONE RENAISSANCE SQUARE
TWO NORTH CENTRAL AVENUE
PHOENIX, AZ 85004-2393

TELEPHONE 602.262.5911
FACSIMILE 602.253.3255

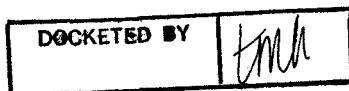
Kenneth C. Sundlof, Jr.
Direct Line: 602.262.5946
Direct Fax: 602.253.3255
E-mail: Sundlof@jsslaw.com



Jennings Strouss & Salmon

Arizona Corporation Commission
DOCKETED

JUL 06 1998



July 6, 1998

Mr. Ray T. Williamson
Acting Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007-2996

Re: *Response of SRP to the 1st Draft of Proposed Revisions to the Retail Electric Competition Rules (R14-2-1601 et seq.)*

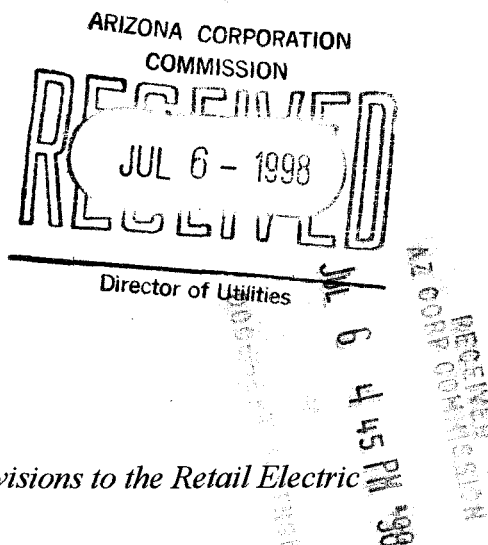
Dear Ray:

In the spirit of cooperation between SRP and the Commission SRP management¹ makes some suggestions as to how the draft rules could be modified to better coordinate with the processes either in place, or expected to be in place, at SRP and to make our joint transition to a competitive market smoother and more effective. SRP will open its service territory to competition at the end of the year. But SRP is counting on the Commission to certify electric service providers to market in SRP's distribution system and to certify scheduling coordinators to interface with SRP as control area operator. And the Commission cannot institute effective competition without coordination with SRP.

We understand the concerns which the Commission has had in the past. But, these concerns have been addressed by the provisions of H.B. 2663, which impose substantial requirements and procedures on SRP. Since H.B. 2663 has addressed the reciprocity issues, coordination between SRP and the Commission should be relatively simple.

We have made a recent suggestion that technical people from SRP and the Commission meet to coordinate our activities on a number of practical subjects. We hope that these meetings will take place as we believe that both SRP and the Commission can benefit through joining forces. We make these comments with the understanding that we will hold a series of meetings to more fully coordinate specific details.

¹ The comments in this letter are those of SRP management. Some of the comments in this letter relate to issues currently being considered by the SRP board.



Comments on Draft Rules

Issue One: Update the Provisions for Reciprocity with Public Power Entities

In the December 1996 version of the rules, the Commission was concerned that SRP would not effectively open its service territory to competition, and thus not provide reciprocity. R14-2-1611 listed three items of particular concern, which the Commission proposed to address through an intergovernmental agreement with SRP: (1) *nondiscriminatory terms and conditions for Distribution Services and other Unbundled Services* (2) *a procedure for complaints arising therefrom*, and (3) *reciprocity with Affected Utilities*.

H.B. 2663 has addressed each of these issues, and quite a few more. On these three, the bill provides for nondiscriminatory terms and conditions for distribution services in section 30-805(a)(1), provides a complaint and appeal procedure in sections 30-802, 30-810 and 30-811, and provides for reciprocity in section 30-803(A).

Because of H.B. 2663, there is no longer any reason why electric service providers should not be licensed statewide, nor any reason for an intergovernmental agreement between the Commission and SRP.

In fact, these concepts are inconsistent with the new law:

30-803 . Competition in retail supply of electricity; open markets

A. Public power entities may participate in retail electric competition statewide and shall open the Service territory currently served by them to competition in the sale of electric generation service Not later than December 31, 1998 for at least twenty per cent of the 1995 retail load at least fifteen per Cent of which shall be reserved for customers in the residential customer class and shall open their Entire service territory to competition not later than December 31, 2000 to electricity suppliers certificated by the commission pursuant to section 40-207 and to providers of other services.

40-202(E). The commission shall order on a nondiscriminatory basis that public service corporations open their distribution territories to competition by public power entities to the same extent and under the same terms and conditions as authorized electricity suppliers are granted access through commission rules or orders.

30-802 . Electric competition; terms and conditions; determination; public notice

A. Public power entities shall determine terms and conditions for competition in the retail sale of electric generation service consistent with the provisions of this chapter. Public power entities and the commission shall coordinate their efforts in

the transition to competition in electric generation service to promote consistent statewide application of their respective rules, procedures and orders.

30-806. Consumer protection; rules; confidentiality; unlawful practice

A. Public power entities shall adopt rules and procedures to protect the public against deceptive, unfair and abusive business practices. public power entities and the commission shall coordinate their respective rules and procedures to promote consistent implementation statewide. . . .

With these concepts in mind, we suggest these rule changes:

Add a new definition to R14-2-1601

"Public Power Entity":

(a) means any municipal corporation, city, town or other political subdivision that is organized under state law, that generates, transmits, distributes or otherwise provides electricity and that is not a public service corporation.

(b) does not include:

(i) a city or town with a population of less than seventy-five thousand persons according to the most recent United States decennial census that does not elect by official action to sell electric generation service in the service territory of another electricity supplier.

(ii) a power district, electrical district, irrigation and water conservation district or multi-county water conservation district established pursuant to title 48, chapter 11, 12, 19 or 22.

(iii) the Arizona Power Authority.

(iv) a city or town with a population of seventy-five thousand persons or greater according to the most recent United States decennial census that elects by official action not to sell electric generation service in the service territory of another electricity supplier.

This definition is identical to that contained in H.B. 2663, particularly section 30-802(16).

Modify R14-2-1611 as follows:

R14-2-1611

A. The service territories of Arizona electric utilities which are not Affected Utilities or Public Power Entities shall not be open to competition under the provisions of this Article, nor shall Arizona electric utilities which are not Affected Utilities be able to compete for sales in the service territories of the Affected Utilities.

B. An Arizona electric utility, subject to the jurisdiction of the Commission, which is not an Affected Utility may voluntarily participate under the provisions of this Article if it makes its service territory available for competing sellers, if it agrees to all of the requirements of this Article, and if it obtains an appropriate Certificate of Convenience and Necessity.

C. An Arizona electric utility, not subject to the jurisdiction of the Commission and which is not a Public Power Entity, may submit a statement to the Commission that it voluntarily opens its service territory for competing sellers in a manner similar to the provisions of this Article. Such statement shall be accompanied by the electric utility's nondiscriminatory Standard Offer Tariff, electric supply tariffs, Unbundled Services rates, Stranded Cost charges, System Benefits charges, Distribution Services charges and any other applicable tariffs and policies for services the electric utility offers, for which these Rules otherwise require compliance by Affected Utilities or Electric Service Providers. Such filings shall serve as authorization for such electric utility to utilize the Commission's Rules of Practice and Procedure and other applicable Rules concerning any complaint that an Affected Utility or Electric Service Provider is violating any provision of this Article or is otherwise discriminating against the filing electric utility or failing to provide just and reasonable rates in tariffs filed under this Article.

D. If an electric utility is an Arizona political subdivision or municipal corporation other than a Public Power Entity, then the existing service territory of such electric utility shall be deemed open to competition if the political subdivision or municipality has entered into an intergovernmental agreement with the Commission that establishes nondiscriminatory terms and conditions for Distribution Services and other Unbundled Services, provides a procedure for complaints arising therefrom, and provides for reciprocity with Affected Utilities. The Commission shall conduct a hearing to consider any such intergovernmental agreement.

Modify R14-2-1603 to Provide for CC&N's in Public Power Entities Distribution Systems

B. Any company desiring such a Certificate of Convenience and Necessity shall file with the Docket Control Center the required number of copies of an application. Such Certificates shall be restricted to geographical areas served by the Affected Utilities and Public Power Entities as of the date this Article is adopted and to service areas added under the provisions of R14-2-1611(B) or added by resolution of a Public Power Entity. . . .

C. At the time of filing for a Certificate of Convenience and Necessity, each applicant shall notify the Affected Utilities and Pubic Power Entities in whose service territories it wishes to offer service of the application by serving a complete copy of the application on the Affected Utilities and Public Power Entities.

Perhaps a better alternative is for the rules to simply provide for statewide CC&N's.

Issue Two: Modify System Access Provisions to Effect a Smoother Transition and to Coordinate Statewide

The technical aspects of achieving a competitive market at the end of the year are very complex and will require intense cooperation between SRP and the Commission in order to achieve a coordinated and workable system of standards and protocols. In this respect, SRP is on track to meet its December 31 start date. While we are not entirely familiar with the precise status of the Commission's efforts, we suggest that the work done by SRP might be of considerable assistance to the Commission in meeting its own start date.

In this respect we suggest rule changes which are intended to help to actually achieve the start date and which help to simplify and coordinate the statewide effort:

Provide for Control Area Operator Agreements

Separation of monopoly and competitive generation functions is a complex issue which will require careful consideration. One aspect of the separation is how will the implementation of the WSCC Control Area Operation functions be affected for the Arizona part of the WSCC interconnected transmission grid. We suggest rule changes to provide for agreements between monopoly entities and control area operator entities. We suggest this new rule in R14-2-1601:

"CAO Service Agreement" means a contract between any electric market facilitator (Scheduling Coordinator, Electric Service Provider, Transmission Provider, and Utility Distribution Company) and the applicable Control Area Operator.

Currently the control area operators in Arizona include SRP, APS, TEP and WAPA (among the 31 CAO's in the WSCC NERC region). SRP intends to continue to serve as

control area operator, and to enter into agreements with parties entering the market. If an Affected Utility is required to divest its generation (not recommended by SRP), it may no longer be able to perform control area functions. The requirement to divest should be delayed until a new mechanism is developed to perform the CAO function. The control area impact needs to be explored and more fully developed in the rules. The Commission might also develop standardized agreements between parties entering the market and the control area operators, as suggested by the above definition.

Clarify the distinction between transmission and distribution

The distinction between distribution and transmission will have increasing importance as competition is implemented. This is particularly true with respect to transmission system access and control. We suggest modifying the definitions of Distribution Primary Voltage and Transmission Primary Voltage to recognize that most of the 69 kV system and some parts of the 230 kV portions of the system is used for distribution. SRP suggests that SRP and the Commission work to develop a functional definition consistent with the operation of the electric system, the pricing of distribution and transmission services and applicable FERC rules.

Clarify provisions and procedures for aggregation

Further work and development needs to occur on the mechanics of aggregation of loads. For example:

- On the definition of self-aggregation, will the customer perform the aggregation or will the customer be required to use an ESP (or Schedule Coordinator) to perform the aggregation? We suggest clarifying this definition to be clear that the customer will use the services of an ESP to aggregate loads.
- R14-2-1603(A) should require a customer to use an ESP to self-aggregate, instead this provision implies that a customer can work directly with a UDC to secure hourly energy supplies to meet aggregated loads. The CAO's will not work directly with customers who want aggregation. The ESP's will aggregate and utilize SC's to perform hourly load and resource balancing. We suggest eliminating "or self-aggregation".
- A major concern with R14-2-1604(B) is that bulk energy is scheduled in hourly one megawatt increments. Since the rules require aggregated "peak" loads to equal one MW or greater in a month, the control area therefor automatically services the load for many hours with an occasional one MW schedule coming from the ESP/SC. For example, the ESP/SC representing a customer using 16,500 kWh in a month would schedule only one MW for 16 hours in the month, in effect banking energy with the CAO. The aggregation of loads should insure that at least one MW is scheduled each hour from generating resources to the aggregated load to minimize cost shifting.

- In R14-2-1605(B) the word "self-aggregation" again appears. If the rules are changed to make it clear that self-aggregators must use certified ESP's/SC's to perform the load/resource balancing function, then obviously the burden of a certification falls on the ESP/SC.

Clarify Buy-Through provisions

R14-2-1604(H) regarding buy-throughs needs to be further developed. The implication here is that an ESP and /or SC is not needed. Under the current rules, it appears that the distribution utility will not buy wholesale power, so somehow the wholesale merchant function will receive an hourly purchase requirement, will buy the required energy, and charge the customer through the billing process. A number of details are missing here. Today we buy energy wholesale and "all" customers benefit. This buy-through provision provides that purchases will continue as in the past, but some of that energy has to go directly to an individual or aggregate of customers. This complex issue needs further development.

Expand and Clarify the Transmission and Distribution Access provisions

SRP is anxious to discuss the procedure to evaluate and implement (if necessary) an ISA or an ISO. In order to meet its December 31 deadline, SRP is soliciting bids from third parties to provide an audit program, which SRP suggests should also be the appropriate interim step for the Commission, especially considering that at least initially competition in the residential and small business markets will be limited. SRP suggests that the Commission first implement an audit program, then evaluate an ISA and ISO through the regional Desert Star effort.

With respect to the specific rules, R14-2-1610 needs to be broken into several parts. Only section A deals directly with access. Other new sections, each covering major topics and a number of issues, would cover the ISA/ISO, Schedule Coordinator roles and operation of must-run units and pricing. SRP makes these specific comments on R14-2-1610:

A. SRP does not agree with this position, especially in the first years of competition. ESP's will try to schedule their resources at Palo Verde, and the system simply will not accommodate all deliveries at Palo Verde. An interim solution needs to be explored, at least through the end of 2000.

B. SRP supports efforts to explore the needs and benefits of an ISA or ISO. But, rather than start a separate effort, SRP suggests that the ACC support the ongoing regional efforts through Desert Star.

C. SRP believes that this provision is promoted by a small group which believes that utilities will not provide fair access. SRP intends to provide choice of ESP with all facets of operation reviewed by a third party audit process. Just as with the ISO, the

Commission should first back attempts to identify the value and need for an ISA and push for its development only after a clear need is determined. The timeline (assuming that it is determined that each is needed) might be to implement a third party auditor in December 1998, and ISA after January, 2001 and an ISO in January 2003. This timeline would give all parties an opportunity to review each step, and during that time to determine whether the next step is necessary.

SRP is also concerned that very few customers may elect an alternate ESP, at least initially. If we look at the California experience, only one percent of the customers have changed. The ISA proposal puts "all" schedules through the ISA program even though 99% of the customers may not be impacted, i.e. the ISA is an attempt to protect the 1% but puts the cost and operating burden on the remaining 99%. If the goal is to minimize the impact on the status quo with non-competitive customers, it is counter productive to require radical changes to operating practices.

D. SRP strongly believes that implementing an ISA by the end of the year is not feasible. Given everything else which needs to be accomplished to achieve customer choice by the end of the year, this is a step which can logically be postponed.

E. This provision should only require that the utilities evaluate the need and justification for an ISO.

F. Since energy prices are market driven, recovery of ISO-related expenses may not occur.

G. This rule assumes that the Affected Utilities will no longer function as Control Area Operators. The ISO may simply provide a security function, therefore the focus of this rule should be to achieve the listed items through an appropriate mechanism, to be developed in the future.

H. A regional spot market will develop on its own if needed. The Commission does not need to take any affirmative action in this regard. (It does not appear that the rule necessarily requires affirmative action by the Commission.)

I. This section should be deleted. Some power marketers have voiced concerns about market power, but the bottom line is that valley units "must run" during certain times of the year to provide electric service during peak summer loading periods and transmission contingencies. Pricing may be an issue to some, but none of the utilities intends to charge a different rate for must run whether or not an alternate ESP is selected. That is, must run unit costs will be prorated so every customer pays the same rate. If this does not occur then the Commission, under its existing authority, can rectify the situation.

Issue Three: Modify the Solar Portfolio Standard

While SRP supports the development of solar resources, and in fact is engaged in several projects in this regard, SRP is concerned that the requirements in this section will seriously limit competition. Most ESP's will not be competitive if they have to tack-on large additional costs to recover the solar resource costs. If an ESP does not have a very large customer load, this requirement will be a total barrier to entry. Even for a large ESP, this requirement will significantly impact margins and the ability to compete where prices for energy are market-based.

SRP suggests that the Commission and interested parties work to develop an alternative method of encouraging solar development, which will not slow the development of competitive markets.

Issue Four: Clarify the stranded cost, divestiture and affiliate provisions

It appears that the stranded cost provisions in these draft rules, and the Commission's recent order on stranded costs, are inconsistent. SRP urges that the Commission work out acceptable compromises with the Affected Utilities on the stranded cost, divestiture and affiliate requirements. If these points are not resolved in to the reasonable satisfaction of all parties, it is likely that the start of competition will be delayed or substantially affected by litigation or other actions.

SRP recognizes that the Commission is not necessarily bound by all aspects of the approach taken by the Legislature on these issues. But, in the interest of achieving statewide consistency and actually starting competition, SRP urges that the Commission consider the approach taken by the legislature on stranded costs. If problems develop in the future, the Commission can always consider alternative options.

From a practical operational viewpoint, especially with respect to jointly owned generating facilities, SRP is concerned about the divestiture requirement. SRP believes that Palo Verde simply is not a candidate for divestiture because of the myriad of requirements problems and issues inherent in owning a nuclear facilities. With respect to coal-fired plants, the Commission should be aware of the restrictions on sale in the various owner/operator agreements, as well as the right of first refusal contained in some of the agreements. It is important to keep some degree of control over the ownership and operation of these important facilities.

Finally, the ten year recovery period is well beyond the legislative cut off date of 2004. This longer period of recovery will limit competition in the distribution territories of the public service corporations and delay statewide competition.

Issue Five: Clarify standard offer provisions

SRP is particularly concerned about the provisions of R14-2-1606(F) which requires, beginning on 1/1/01, competitive bidding for the standard offer service. This provision potentially eliminates any and all opportunity to minimize the impact on customers electing to stay with their current electricity supplier. First, the provision subjects all customers not electing choice to market prices. But, more importantly, this provision would facilitate market control by one entity, bidding on the standard offer service of all Affected Utilities. Clarification is needed on this entire rule, and particularly subparts (A), (B) and (F).

Issue Six: Some provisions of the rules are inconsistent with the legislatively-imposed requirements on Public Power Entities

SRP recognizes that the legislation in many respects only makes suggestions to the Commission. However, all parties are interested in statewide consistency. For that reason, SRP points out the provisions of the rules which are inconsistent with the legislatively-created scheme:

R14-2-1604(B): The legislation provides for twenty percent of the 1995 load to be competitive without regarding to customer size. The 1 MW and above requirement is inconsistent.

While the issue of stranded cost recovery is not clearly defined by the draft rules, it appears that the Commission-imposed schedule of recovery may be different that the 2004 cut-off set by the legislature.

Other suggested changes to the draft rules

Set forth below are a number of additional suggested changes, not necessarily falling in any of the above categories:

R14-2-1601

15. Remove the word "adequate".
17. "Load Profiling" is a process of estimating customers' hourly energy consumption based upon a statistical sampling of similar on-measurements-of similar customers.
19. "Meter Reading Service" means all functions related to the collection and storage of electricity consumption data.
25. "Scheduling Coordinator" means an entity that provides balanced schedules for power transactions over transmission ~~or distribution~~ systems to the

party responsible for the operation and control of the transmission grid, such as a Control Area Operator, ISA or ISO. Note also, the ISA is not responsible for operation and control of the transmission grid.

R14-2-1603

F. There appears to be an inconsistency on the defined term for an agreement between an ESP and the UDC.

R14-2-1604

C(4)(d) The word "actual" should probably be "typical". The actual load profile for a customer starts with a 24 hour profile but is adjusted throughout the month, based upon actual system loads, to become (in a 30-day month) a 720 hour profile.

R14-2-1605

A. Clearly only generation that can be delivered to the customer's load qualifies. The word "any" should be removed and add "at locations where delivery over transmission and distribution systems is assured".

R14-2-1606

J. These workshops should take place before the Commission adopts a ruling. The Commission should understand the impact of this issue before a direction is established.

R14-2-1609

E. In a competitive environment ESP's will not have the kind of margins needed to pay 30 cents per kWh in penalties. We are looking at *total* energy prices of 3 to 4 cents per kWh in the short term.

R14-2-1612

K. The marginal cost requirement will cause a major problem for ESP's securing energy from the market. If the ESP provides a fixed price to the customer, it is quite likely that during certain periods of time the price to the customer will be well below the marginal cost of the ESP. Most likely, the marginal cost concept is unnecessary in the rules.

R14- 1613

E. Affected customers should not be concerned with distribution and most ancillary services. The Affected Utility (UDC) will provide these services. The customer simply has to find another ESP who is responsible for securing transmission and generating resources.

G. The Commission should explain what is meant here. It is likely that the ESP will never know that its energy customers were curtailed. The curtailment will be reflected in the metered consumption. The UDC will re-establish service as soon as possible.

I. 1. Access to customer information will require the advance consent of the customer.

4. It is not clear what the intent is here. This provision seems to limit where a customer can get its electricity.

8. This could be worded better. The ESP's/SC's will use load profiling, not the competitive customer.

13. This provision should reflect that on- and off-peak hours are identified by NERC.

R14-2-1614

A(10). The type of source of most energy supplies delivered from the bulk power market will be unknown. The source is simply the control area where the generator(s) are located. This provision could provide that information be provided if it is available.

R14-2-1618

This provision appears to require unnecessary detail and will tend to limit competition.

C(7)(a) This provision will put a substantial limit on market place transactions. This type of reporting was required by FERC years ago, only to be dropped later because it was nearly impossible to get the data.

Conclusion

We do not have much time to accomplish the many things which need to be done before the start of competition. SRP and the ACC will accomplish the transition more easily by working together. SRP has suggested some operational level meetings to quickly accomplish the necessary tasks. We are anxious to get started with this process.

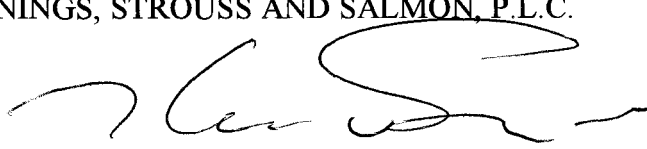
Ray T. Williamson
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In the meantime, SRP is also available to discuss and expand on these comments. Thank you for your cooperation to date.

Very truly yours,

JENNINGS, STROUSS AND SALMON, P.L.C.

By



Kenneth C. Sundlof, Jr.